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REPORT OF THE SECRETARY-GENERAL ON THE ACTIVITIES OF THE OFFICE OF INTERNAL OVERSIGHT SERVICES

Note by the Secretary-General

1. Pursuant to General Assembly resolution 48/218 B of 29 July 1994, the Secretary-General has the honour to transmit, for the attention of the General Assembly, the attached report, conveyed to him by the Under-Secretary-General for Internal Oversight Services, on the investigation of alleged misappropriation of United Nations assets at the United Nations Gift Centre.

2. The Secretary-General concurs with the findings and recommendations for corrective action contained in the report.

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Report of the Office of Internal Oversight Services on the investigation of the alleged misappropriation of United Nations assets at the United Nations Gift Centre

I. BASIS OF INVESTIGATION

1. The review by the Investigations Section of the Office of Internal Oversight Services into the United Nations Gift Centre (Gift Centre) was conducted following receipt of a report that mismanagement by the General Manager had resulted in the misappropriation of United Nations assets at the Gift Centre and in the decrease of its profits. The review concerned the operation of the Centre during the period from 1 January 1992 to 30 June 1994.

2. The Gift Centre is a commercial activity located in the visitors' area of the United Nations General Assembly Building in New York. The Organization, which owns the capital, assets and revenues of the Gift Centre, in 1986 entered into a labour contract with Ogden Allied Building and Airport Services, Inc. (Ogden) for the provision of personnel for the Gift Centre. The current contract with Ogden was signed on 5 March 1994 and covered the period from 1 October 1993 to 14 February 1995, inclusive. After the contract expired on 14 February 1995, it was renewed on a month-to-month basis pending further review of the Gift Centre's operations by the Commercial Activities Service, Office of Conference and Support Services, which has been responsible for the operations of the Gift Centre since May 1993. Prior to that date, the responsibility rested with the Purchase and Transportation Service.

3. Consequently, all personnel working in the Gift Centre are employed by Ogden, not the United Nations. However, an Administrative Officer (previously an Administrative Assistant) from the Commercial Activities Service is responsible for overseeing Gift Centre operations.

4. During the investigation, the Gift Centre personnel was composed of a General Manager, an Assistant Manager/Buyer who also functioned as a supervisor, two supervisors, a bookkeeper, a secretary, 16 cashiers and 4 men who worked in the stockroom. The designated Buyer for the Gift Centre had been released from his duties by the General Manager in October 1993, and between October 1993 and September 1994 the General Manager assumed the responsibilities as Buyer in addition to his duties as General Manager. The position, vacant for almost one year, was filled in September 1994 by one of the supervisors who had been recently promoted to Assistant Manager.

II. NATURE OF THE ALLEGATIONS

5. The source of the allegations of mismanagement first approached the former Assistant Secretary-General for the Office of Inspections and Investigations in December 1993, noting that in his opinion a decrease in Gift Centre profits was directly attributable to incorrect management practices. The Assistant Secretary-General assigned the case for investigation in February 1994 and the investigation was completed by the Investigations Section of the Office of Internal Oversight Services in 1995. The source provided the Section with

information that indicated mismanagement at the Gift Centre. United Nations staff members and Gift Centre employees also came forward voluntarily and provided additional information, but none of their suspicions was based on first-hand information or could be corroborated by documentary or testamentary evidence.

6. In evaluating the documentary evidence presented to the Office by these voluntary sources, it was found that most were inaccurate or provided a distorted description of aspects of the Gift Centre operations and did not support the allegations raised against the Gift Centre management. Moreover, one source of information, who had been dismissed, was unable to supply either corroborative evidence or sufficient detail to allow the Investigations Section to confirm his report.

7. However, the investigation was not based only on the statements or documents provided. It was noted that irregularities in the internal controls of the Gift Centre had been recorded for the past several years by the External Auditors and by the Audit and Management Consulting Division of the Office of Internal Oversight Services in the form of audit observations. Most recently, the management letter on the first interim audit of the United Nations Headquarters for the biennium 1994-1995, issued on 7 February 1995 to the Under-Secretary-General for Administration and Management, raised concerns over the decrease in receipts and called for better supervision and control of the Gift Centre. In the review of purchase orders and receiving and inspection reports, significant internal control lapses or overrides and improper safeguarding of United Nations assets were identified.

III. INVESTIGATION SUMMARY

8. The findings of the review were discussed with the Gift Centre General Manager for his comments. Operations at the Gift Centre were also discussed with the Chief of the Commercial Activities Service and others.

9. Because of inadequate, missing or non-existent documentation of Gift Centre activities managed by Ogden, it was not possible to confirm that either funds or other assets had been misappropriated, but neither were they safeguarded. The United Nations has allowed deviations from its Financial Rules and from sound retail management practices by failing to monitor Ogden's management, which received substantially increased fees without being held to any industry standards (see paras. 14 and 16 below).

10. The findings set forth in the present report raise basic questions about the Gift Centre Manager's ability to implement even the simplest of controls. They indicate that the General Manager did not abide by the Financial Rules of the United Nations or written procedures, and regularly engaged in overriding what few controls had been established. From those observations (and those raised in the internal and external auditors' reports), serious doubts were created regarding the General Manager's competence and good faith to continue in that position because of his direct non-compliance with his duties as General Manager.

11. It was recommended that the Commercial Activities Service evaluate the appropriateness of the Ogden contract. In his comments following his review of the findings, the Chief of the Service stated that he had never been totally satisfied with the Gift Centre Manager's performance; that the General Manager did not necessarily project the right image for the United Nations; and that he was not as responsive to the United Nations concerns as he should be. The current renewal of the Ogden labour broker contract for a limited period (month-to-month) will provide the Commercial Activities Service with time to determine how best to manage the Gift Centre. The Chief of the Service stated that the Organization had three options: (a) to undertake the whole operation itself, while acknowledging that it lacked the requisite experience; (b) to identify and enter into a contract with a labour broker with experience in this type of operation; or (c) to farm out the entire operation. The Commercial Activities Service is currently in the process of requesting bids from contractors who would operate the Gift Centre and pay the United Nations a rental fee plus a percentage of the receipts.

12. The Chief of the Commercial Activities Service also acknowledged that the United Nations contract with Ogden was not only the sole retailing contract that Ogden had, but that Ogden had no experience in the retailing area prior to receiving the United Nations contract. The Office of Internal Oversight Services has raised questions with the Service about the selection process, in particular, in view of the selection of a totally inexperienced broker for the United Nation's sole commercial enterprise.

13. The results of the investigation also indicate a lack of supervision of the Gift Centre on the part of the Commercial Activities Service, which permitted the non-compliance with and overriding of Gift Centre procedures. The Service's presence was not even minimal, being neither regular nor effective at the Gift Centre. No documents indicate that the Service identified, much less attempted to correct, the cited practices before the review by the Office of Internal Oversight Services. The Office reiterated to the Service the recommendation, originally made by the External Auditors, calling for closer supervision and suggested that the Administrative Officer or Assistant should be located permanently at the Gift Centre and not simply spend part of her/his workday at the store. As such, she/he will be able to monitor the Gift Centre operation and possibly deter inappropriate actions taken by Gift Centre personnel. In response to that recommendation, the Service has agreed to increase supervision of the Gift Centre by creating an office for the Administrative Officer at the Gift Centre so that she may be constantly present and by monitoring all activities during the store's daily operations.

IV. FINDINGS OF THE INVESTIGATION

A. Lack of correlation between gross receipts and the cost of sales

14. Copies were obtained of the United Nations General Fund Schedule of Revenue Producing Activities for the past four bienniums (1986-1987, 1988-1989, 1990-1991 and 1992-1993) and the financial statements pertaining to the United Nations Gift Centre were analysed. Initial analysis revealed that there had

been a decrease in receipts during the two last bienniums (1990-1991 and 1992-1993) of 12 per cent and 15 per cent, respectively. The excess of income over expenditures indicated a sharp decrease in net income over the same two bienniums of 11 per cent and 58 per cent, respectively. The current General Manager started to work for the Gift Centre in June 1992.

15. In order to measure the significance of this decrease, the numbers of visitors who took guided tours of the United Nations were obtained from the Visitors' Bureau. Although the numbers of visitors cannot be directly correlated to the purchases made at the Gift Centre, the fluctuation and changes in the numbers can show a relationship to the fluctuation in sales because the visitors to the United Nations are the major source of customers of the Gift Centre. According to the Office's review, the number of visitors decreased during the last two bienniums (1990-1991 and 1992-1993) by 2 per cent and 8 per cent, respectively, but not as dramatically as the decrease in the Gift Centre's net income. Although the guided tours were suspended from 18 September to 30 November 1993, the Gift Centre was not closed during that period. The decrease in gross receipts can be correlated to the decrease in visitors, but the amount of the decrease in net income cannot.

16. In income section 3, Services to the public, of the second performance report on the programme budget for the biennium 1992-1993 (A/C.5/48/48/Add.IS3), the Secretary-General reported an expected decrease of $62,300 in expenditures, which was attributed mainly to reduced requirements for established posts and common staff costs. However, it is interesting to note that the staff and personnel costs actually increased substantially, by $545,000, or 48 per cent, from the biennium 1990-1991. Further, Ogden's management fees also increased substantially, by $43,688, or 88 per cent, from the biennium 1990-1991. The percentage of management fees to total operating expenditures also increased from the biennium 1990-1991 by 3.8 per cent to 5.05 per cent in the biennium 1992-1993.

17. In the United Nations financial statement, the Gift Centre reported that the cost of sales during the biennium 1992-1993 was $2,951,608. In order to determine the reasonableness of the amount reported as gross receipts, a financial analysis was performed using a sales price to cost-of-sales ratio of 2.7. This ratio was calculated by the Commercial Activities Service based on the average for all daily sales during the biennium (except for one quarter that was not available). With such a pricing policy, the cost of sales that was reported in the financial statement for the biennium should have yielded gross receipts of $7,969,342, whereas actual receipts totalled $6,038,578.

18. This issue was brought to the attention of the Chief of the Commercial Activities Service, who disagreed with the estimate. It was explained that the estimate was based on the cost-of-sales amount reported in the United Nations General Fund Schedule of revenue-producing activities for the biennium 1992-1993. He then acknowledged that the amount had been inaccurately reported in the schedule and that several adjustments had had to be made to that official report. The proposed adjustments included reducing the cost-of-sales amount by the following:

(a) The sum of $217,000, relating to merchandise, was received and included in inventory but not obligated in the biennium 1990-1991 but paid for in the biennium 1992-1993. The Chief of the Commercial Activities Service indicated that this was an anomalous situation that would not occur in future bienniums;

(b) The sum of $134,604.31, relating to unliquidated obligations, should have been, but was not, liquidated at the end of 1993;

(c) The sum of $134,167.57, relating to changes in inventory value, was recorded incorrectly in the Working Capital Fund. It is gratifying to note that the Service has discussed this adjustment with the Accounts Division and the Controllers Office in the effort to present true and accurate numbers in future financial statements;

(d) A total of $100,000 of freight and supplies was included in the cost-of-sales amount, which the Commercial Activities Service asserts should not have been included for the purpose of the financial calculation.

19. In addition, the Commercial Activities Service proposes an increase of $214,557 to the gross receipt amount, which it calculates to represent the discount amount given to staff members of the United Nations and related agencies, as well as to members of missions to the United Nations of Member States.

20. By taking all five of the proposed adjustments by the Commercial Activities Service to the cost-of-sales and gross receipt data reported in the United Nations General Fund schedule of revenue-producing activities for the biennium 1992-1993, the cost-of-sales amount is reduced to $2,365,836 and the gross receipts amount is increased to $6,253,135. Using the same financial hypothesis calculation as described in paragraph 17 above, the 2.7 ratio would yield a gross receipts amount of $6,387,757.

21. However, the quantity and significance of these proposed adjustments - 20 per cent of the cost-of-sales amount - when combined with the inadequate and incorrect record-keeping practices and dearth of documentation required the Gift Centre management to address changes in the maintenance and reporting of financial data for the Gift Centre.

B. Lack of segregation of duties in the responsibilities of the General Manager

22. The Gift Centre's General Manager had assumed several functions, in addition to those of the General Manager, that compromised the integrity of the operation of the Gift Centre and violated the accounting principle of segregation of duties, which is a primary internal control. The General Manager called the vendors, determined the quantities of merchandise to be ordered, authorized and approved purchases, received and stocked the delivered merchandise (and even certified its receipt in several cases), and then prepared and signed the disbursement voucher for payment. All of these functions were assumed and fully controlled by the General Manager with at least the tacit

approval of the Gift Centre Administrative Officers/Assistants and the Commercial Activities Service.

C. Irregularities noted in the review of purchase orders and receiving and inspection reports

23. As mentioned in the introduction to the present report, a review was made of all invoices, purchase orders and receiving reports for the period from January 1992 to July 1994. In the course of the review, many cases were noted in which the controls were overridden by Gift Centre management, that is, the General Manager and the Commercial Activities Service, thus permitting a major breakdown in internal controls, and seriously flawed or non-existent documentation, which would allow for the misappropriation of United Nations assets to occur. These failures of internal control included:

(a) Purchase orders issued subsequent to the receipt of the invoices;

(b) Changes made to purchase orders after they were signed and authorized;

(c) Invoice prices greater than the amounts authorized on the purchase orders;

(d) Increases to amounts invoiced by vendors;

(e) Purchase orders issued out of numerical sequence;

(f) Receiving and inspection reports signed by non-stockroom personnel;

(g) Invoices billed for quantities greater than the quantities received.

D. Absence of a buying plan, re-order points and economic order quantities in the purchase of Gift Centre merchandise

24. It was also determined from observation and the absence of any evidence to the contrary that there was no formalized control over purchasing inventory and implementing basic inventory management concepts such as re-order points and economic order quantities. Merchandise was ordered only when the stock reached nearly zero, indicating that no re-order points had been established. In addition, excessively large quantities of several merchandise items were purchased (at no apparent cost savings), which a buying plan should have prevented.

25. The lack of a purchasing programme was previously pointed out to the Gift Centre Management in a memorandum from the former Administrative Officer and reiterated by the external auditors in a management letter on their audit of the United Nations Gift Centre for the biennium 1992-1993. However, neither was heeded by the Gift Centre management. The Chief of the Commercial Activities Service has indicated that, in view of the plan to contract out, the stock is in

the process of being reduced and only highly merchandisable stock is being re-ordered.

E. Lack of an adequate management information system

26. The Gift Centre does not have a management information system that can provide a concise sales history that would enable management to make educated purchasing decisions. The Gift Centre retail track system can produce an inventory report that lists each item carried by the Gift Centre by UPC code and gives the past 10 months' sales history for each item. The report is not produced regularly and according to Gift Centre personnel it is not utilized, nor is any other management information report with details of past sales history produced regularly.

27. The computerized inventory system is connected with the cash register, which accounts for each item sold. It can only be overridden by the General Manager who has a key to void a sale. According to the external auditors, the inventory printout is used only for accounting purposes (i.e. year-end financial statements) and not for control purposes.

F. Failure in the control over the reconciliation of actual and recorded inventory

28. In reconciling inventory reports for several periods, discrepancies were noted for various inventory items. Furthermore, both the internal and external auditors have made observations in their reports of serious problems regarding the reconciliation of the physical inventory count with that of the recorded inventory. Discrepancies between actual counts and the printout are simply written off without determining the underlying cause of the discrepancies or analysing them for patterns of theft or other abuses. This write-off practice provides a method by which stolen or otherwise unaccounted for purchases may be hidden.

29. The Gift Centre procedures manual calls for spot inventories to be conducted on a daily/weekly basis and for a running inventory to be maintained in the stockroom and verified once a month by non-stockroom personnel; ad hoc inventories may be carried out at any time upon instructions from the Chief of the Commercial Activities Service. The external auditors had recommended that spot-checking of selected items, in particular inventory items of high value, be undertaken more often. Management agreed with their recommendation. The former Administrative Assistant claimed that spot-checks were performed, but no manifest or other documentation was found to support this claim.

G. Lack of reconciliation of Gift Centre financial statements with the financial statements prepared by the Accounts Division

30. The Gift Centre's monthly financial statements were not prepared on a timely basis. Further, the Gift Centre did not coordinate with the Revenue Accounts Unit in the reconciliation of monthly financial reports to ensure that the figures reflected in schedule 2.1 of the United Nations General Fund financial statements agreed with their records and to account for any discrepancies.

H. Duplicate payment of an invoice

31. A double payment in the amount of $3,000 was made to the vendor Empire Gift Connexion for the purchase of 5,000 United Nations fiftieth anniversary gold-plated pins.

I. Irregularities in recording the receipt of inventory

32. Two instances were noted in which two separate deliveries of merchandise were recorded on the same receiving and inspection report. Owing to the inadequacy of the records maintained at the Gift Centre, it is not possible to determine if these were double payments, double deliveries recorded on the same receiving and inspection report, or a means of adjusting documentation to correct an earlier discrepancy.

J. Failure in internal controls over the handling of cash

33. Internal controls over the handling of cash are weak. Established procedures that authorize only cashier personnel to operate the cash registers and to record sales in their respective cash registers were not strictly enforced. Furthermore, a procedure requiring that void transactions be recorded and duly signed by a Supervisor at the time of the transaction was routinely overridden by Gift Centre personnel with the full knowledge of the General Manager. The procedures manual also requires that every month at least one surprise pull be undertaken to check cash procedures and verify receipts. However, this procedure was not complied with either. The inability of the General Manager to enforce even these established procedures demonstrates the ineffectiveness of the current Gift Centre management.

34. One of the allegations raised was that sales were completed by the cashiers but not rung on the cash register. Controls are not in place to detect and deter such activity, which would allow the misappropriation of funds received. In order to confirm this allegation, it would have been necessary to find a witness to someone performing such a sale, as there is no mechanism or other control system to detect this practice.

K. Irregularities on discount sheets

35. A uniform and authorized discount policy is not in place at the Gift Centre. Discounts greater than the 20 per cent permitted in the Gift Centre procedures manual were given to United Nations staff, affiliates and related agencies.

L. Irregularities noted on time cards

36. Several employees had a significant number of time cards where the time had been manually altered or overridden by manual entries instead of being entered by the bundy clock. Two employees had their time cards manually adjusted at least once in each week for more than half of the 52 weeks reviewed. Manual adjustments to the time cards overrides the purpose of having a bundy clock, which controls the time entries as personnel arrive and leave work.

M. Other irregularities noted

37. During the course of the investigation of the Gift Centre, other irregularities were also noted, including:

(a) The doors to the jewellery display cases in the Gift Centre were not securely locked and one door was missing;

(b) The lack of internal controls increased during periods when the computer system was down. Cash receipts were not given to customers and open cash drawers were in public view during a two-and-a-half-week period when the computer system was down and the cash registers were not operational and Gift Centre management took no action to protect these assets;

(c) During the course of the investigation, reports were received that keys to the Gift Centre premises and the register void key had been lost but the locks not changed;

(d) Reports were also received that Gift Centre personnel brought their bags on to the Gift Centre sales floor, and according to the Gift Centre General Manager, personnel are allowed to bring their money with them into the store, providing an opportunity for co-mingling of funds.

N. Lack of supervision by the Commercial Activities Service

38. It is th opinion of the Office of Internal Oversight Services that many of the findings noted above would not have occurred had supervision by the Commercial Activities Service been closer and more effective, for example, if the Administrative Officers/Assistants had a more permanent presence at the Gift Centre who actively monitored its activities. The non-compliance with the Financial Rules of the United Nations, the unreliability of Gift Centre data and the overriding of even the few internal controls that did exist could occur only

where supervision permitted such practices to flourish as blatantly as was done in the Gift Centre.

V. RECOMMENDATIONS FOR CORRECTIVE ACTION

39. The Office of Internal Oversight Services recommends that the following corrective action be taken:

(a) Replacement of the Gift Centre General Manager. Although the current contract with Ogden is under consideration, it is not known if and when the current one-month contract extensions with Ogden will terminate; therefore, in view of the poor performance by the current Gift Centre General Manager, the Commercial Activities Service should request Ogden to provide a replacement for his duties;

(b) Segregation of the General Manager's responsibilities. The duties and responsibilities of the Gift Centre's General Manager should be segregated from the duties and responsibilities of other personnel so that the same individual is not responsible for ordering merchandise, authorizing the purchases, approving the purchases, receiving the merchandise, certifying receipt and authorizing payment;

(c) Adherence to procedures established in the Gift Centre procedures manual. Procedures already established in the Gift Centre procedures manual should be strictly enforced and adhered to by all Gift Centre personnel. Specifically, the investigation noted that the following procedures should be re-enforced:

(i) Purchases should be made only after a purchase order has been duly prepared and authorized;

(ii) Changes should not be made to purchase orders; in the event they are needed, an amended purchase order should be prepared and authorized to supersede the original purchase order;

(iii) Invoiced amounts should not be adjusted without supporting documentation from the vendor and the written approval of management;

(iv) Purchase orders should be issued in numerical order and the pre-printed number should not be changed;

(v) Only stockroom personnel should be authorized to receive merchandise;

(vi) Random spot-checking of inventory should be conducted and findings recorded;

(vii) A register intervention sheet should be completed each and every time that there is a register intervention;

(viii) Surprise cash counts and verification of receipts should be performed monthly by the Administrative Officer/Assistant;

(ix) There should be a uniform and authorized discount policy which should be comprehensive and complete and included in the procedures manual;

(x) Employees should be reminded of their responsibility to punch their time cards in and out and manually filled-in times should be kept to a minimum and allowed only with authorization under the Supervisor's signature;

(xi) The display cases should be monitored to ensure that the merchandise is securely locked;

(xii) Non-Gift Centre personnel should not be left unattended in the Gift Centre;

(xiii) All employees, including the Gift Centre General Manager, should abide by the procedures manual and leave all of their personal belongings, including their cash, in the lockers provided to them;

(d) Formalization of a buying plan. Such a programme will control the buying process and set limits as to the quantities purchased. This allows for a better control over inventory and limits the possibility of inventory obsolescence that may occur as a result of excess inventory quantities. In addition, a regular buying programme and improved inventory control will allow for better use of the stockroom area by reducing the space requirements for excess inventory. Furthermore, the Commercial Activities Service Administrative Officer/Assistant assigned to the Gift Centre should closely monitor purchases that are made in large quantities to ensure that these purchases really do result in a saving to the Organization;

(e) Management information system. The Commercial Activities Service should purchase an adequate computer system for the Gift Centre that can meet its operational needs and provide management with the resource tools to monitor and handle Gift Centre resources effectively and efficiently. The implementation of such a system will result in inventory records that should be complete, accurate and up to date, and be used to perform reconciliations of sales records to the inventory records. A proper database program should be maintained that indicates the payment of invoices; this program should not allow changes to be made without leaving an audit trail.

Administration should also improve the register system by purchasing scanning equipment that will automatically scan the merchandise prices and thereby eliminating the need for the cashier to input the price on the register. These registers should ensure that any alteration of the recorded inventory leaves an audit trail;

(f) Financial statements prepared on a timely basis. Monthly financial statements should be prepared on a timely basis and passed on to the Accounts Revenue Unit. These statements should also be reconciled with the figures reflected in schedule 2.1 of the semi-annual United Nations General Fund financial statements in accordance with prior audit observations;

(g) Recovery of double payment. Attempts should be made to recover the $3,000 double payment from the vendor. If the amount is not recovered from the vendor, then those individuals who certified the invoice for payment are accountable to make restitution of this amount to the Organization;

(h) Enhance cash controls. Controls should be implemented to secure the cash handling process, especially when the computer system is malfunctioning, such as giving customers receipts for their purchases and keeping the cash drawer hidden from public view;

(i) Increased supervision by the Commercial Activities Service. The Administrative Officer/Assistant is the Organization's representative at the Gift Centre. He/she should be holding office full time at the Gift Centre and be a constant presence and active monitor in the store. In order to deter the possibility of cashiers not ringing sales on the cash registers, the responsibilities of the Administrative Officer/Assistant should include a more vigilant presence on the sales floor and he/she should observe the sales operations, as well as monitor the performance of the Gift Centre General Manager and Supervisors.

40. The Chief of the Commercial Activities Service has informed the Office of Internal Oversight Services that the majority of these recommendations have been implemented, except for a key recommendation: the replacement of the Gift Centre General Manager. The Chief of the Commercial Activities Service has told the Office that he does not have sufficient evidence, even with the findings of the present report, to present to Ogden in order to request replacement of the General Manager.

41. The recommendations that request the formalization of a buying plan and the investment of a computer system that would account for inventory from the point of receipt at the stockroom to the point of sale have also not been implemented. While the Commercial Activities Service did accept these recommendations, they have not been implemented because of the plan to contract out the operation of the Gift Centre.

42. The Office of Internal Oversight Services is pleased to acknowledge the full cooperation and support of the Assistant Secretary-General for the Office of Conference and Support Services and the movement towards corrective action by the Commercial Activities Service.